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HUD CONSUMER BULLETIN

FINANCING HOME PURCHASES AND HOME IMPROVEMENTS

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FEDERAL HOUSING ADMINISTRATION
Washington, D.C. 20410

"Consumer credit and mortgage debt on urban family homes together total over $250 billion.

"The cost of such credit must be made as clear and unambiguous as possible, eliminating all possibility of abuse."

Lyndon B. Johnson

FHA Loan Insurance System

Under the FHA program home loans are obtained from private lending institutions and the homes are built by private builders. FHA insures the lender against loss in case the borrower should fail to repay the loan in full. It also requires that proposed homes be built in conformance with certain minimum property standards.

Lenders, because they are insured against loss, can accept smaller down payments and make loans over longer periods and under less restrictive conditions than they might without the insurance.

This system of loan insurance works to the benefit of the home buyer. It has brought millions of people into the home buying market who might not otherwise have been able to obtain the type of loans needed.

To finance its operations, FHA charges an initial application fee, and an insurance premium of ½ percent a year on the average scheduled mortgage loan balance outstanding during the year. The premium is included in the borrower's monthly payment. The FHA insurance charge for Title I home improvement loans is paid by the lender from the financing charge paid by the borrower.

This bulletin explains some typical interest charges and other financing costs on a home purchased or improved under FHA programs. Also, it contains a guide to home buying ability.

Home Mortgage Loans

When a person borrows money to buy a home, he pays interest and other charges for using the borrowed money. These charges add to the cost of buying the home. So the would-be home buyer should arrange for a home loan as carefully as he would arrange for any other large purchase.

He should shop around and get the facts from various lenders, just as he shopped around and got the facts from various sellers before selecting the home he wanted.

Before entering into a contract to buy a home he should know:

- How much he needs to borrow to buy the home.
- How long he should take to repay the the loan.
- How much the loan is going to cost him.

By borrowing as little as he needs and repaying the loan as quickly as possible the borrower can save on interest.

For instance, on a $10,000 loan at 6 percent interest, the monthly payment to principal and interest is $11.70 less if the loan is made for 30 years than if it is made for 20 years. But the total amount of interest paid in 30 years would be $4,373.25 more than that paid in 20 years. In other words, a 30-year loan would cost about 61 percent more in total interest than a 20-year loan.

Many families can own their homes and raise their living standards only by using long-term loans with low monthly payments. But interest costs on long-term loans can become very high. So the borrower should weigh carefully the relative advantages of a longer or shorter term loan.

Discounts and Closing Costs

The rate of interest that lenders can charge on FHA-insured mortgages is lower at times than the yield required by lenders in the market. For this reason, lenders sometimes discount FHA mortgages—that

is, they charge points to make up the difference between the FHA interest rate and the yield required in the market. A point is a dollar per hundred dollars of the mortgage amount. The number of points charged varies in different places at different times and among different lenders.

Discount points are not charged by or paid to the FHA, and FHA does not set the number of points that a lender charges.

Because FHA regulations prohibit the home buyer from paying a discount, the lender may require the builder of the house or the person selling it to pay the amount. If the borrower is building a home to live in or refinancing a property on which there is an outstanding mortgage, the lender can ask him to pay a reasonable discount.

FHA regulations do allow the buyer to pay an initial service charge, if the lender requires it. This charge can be no more than 1 percent of the mortgage amount, except when the lender makes inspections and partial disbursements during construction of a property that is either being built or to be built. In such cases, the charge can be as much as 2½ percent.

The borrower pays the FHA application fee, recording fees and taxes, title examination and credit report costs, and other closing costs.

Determining Home Buying Ability

The chart on page 7 points out the types of things considered in calculating a borrower's ability to pay. Anyone can use this chart to figure out his own ability to carry a mortgage in a certain amount.

Family Income and Circumstances

Different families place importance on different things. Some may be willing to give up a great deal to own a home; others may not. Therefore, even if two families have the same amount of income, the amount one family can safely spend on

home ownership may be much more or less than the other family can afford.

FHA Review of the Transaction

Of course no one wants to assume a debt he can't handle, nor does FHA want that to happen. On a home bought with an FHA-insured mortgage, FHA's complete credit review helps to avoid such a problem.

The review is made after an approved lender submits the application to FHA. It covers appraisal of the property and the neighborhood. It also covers careful analysis of the buyer, with study given to why he wants to buy the property and how much money he expects to have available to pay for it—the same factors he, himself, weighs when he decides what he could pay for a home. This analysis is intended to serve as a safe-guard for the buyer in the transaction, as well as to determine FHA's risk in insuring the loan.

FHA Estimates of Ability to Pay

In judging whether it would be feasible to insure a particular mortgage, FHA makes three estimates related to the borrower's ability to meet monthly payments on the mortgage. They are estimates of:

- Effective income—what the borrower has in the way of income that can be counted as dependable and continuing.
- Prospective monthly housing expense—what it will cost the borrower to occupy the property.
- Total amount of the borrower's debts, living costs, and other financial obligations.

Dependable Income

As a rule, it takes a long time to pay off a mortgage. So it is seldom sound for a borrower to base the amount of housing expense he will be able to pay on the prospect of raising his income above his salary. A better base is a realistic estimate of current dependable income. In making such

an estimate, FHA screens out all income except that of a continuing nature.

Money from overtime work, work of other members of the family, return on a capital investment, renting of a room, or payment for occasional services can rarely be viewed as dependable, continuing income. A wife's salary may be counted if her working is an established pattern in the family life.

Housing Expense

There's more to housing expense than mortgage payments and taxes. Other items generally included are hazard insurance premiums, maintenance and repair costs, and utility charges.

FHA compares the housing expense on the home the borrower will be buying with the housing expense he is used to paying. If the prospective expense is greater and the borrower has been unable to save any money while paying the smaller amount, there will be more risk in his undertaking the added expense. The only way he could pay the increased amount, without having a corresponding increase in his income, would be to cut down on other living expenses. This usually is a hard thing to do.

Total Financial Obligations

It is very important to weigh total financial obligations against income.

If, to buy a certain home, the borrower would have to give up too many things important to him, he might find home ownership burdensome. Also, without a proper balance between obligations and income, he might not be able to set aside money for emergencies. This, in turn, could lead to forced sale or to loss of his home.

On the other hand, if the balance is such that there is enough income to meet all obligations without strain, the purchase of a home can bring lasting satisfaction.

In arriving at a proper balance between prospective housing expense and net effective income, FHA considers various factors.

Among these factors are the housing expense normal for the person's income bracket, and his use of installment credit as reflected in the items on the family budget.

Expenses and Obligations

Income (monthly)

Your take-home pay	$	
Wife's take-home pay (if she is steadily employed)		
Total income		$

Housing Expenses (monthly)

Estimated payment on mortgage loan:	
Principal	$
Interest	
Mortgage insurance premium (if FHA)	
Hazard insurance premium	
Taxes and any special assessments	
Estimate for maintenance and repairs	
Estimate for utilities:	
Light	
Heat	
Water	
Air conditioning	
Total	$

Living Expenses (monthly)

Food	$
Clothing	
Insurance premiums (theft, liability, life, accident, hospital, etc.)	
Education	
Medical and dental	
Automobile (operation, license, repairs)	
Transportation	
Recreation and entertainment	
Emergencies	
Miscellaneous (dues, contributions, etc.)	
Total	$

Fixed Obligations

Installment payments (automobile, appliances, furniture, etc.)	$	
Other debt payments (personal loans, etc.)		
State income taxes		
Retirement fund		
Miscellaneous (support of parent, etc.)		
Total	$	
Total expenses and obligations		$

No ready formula can be used to relate either housing expense or purchase price to a prospective home owner's income. FHA considers both the borrower's income and his age, but only as they relate to other factors that affect his ability to repay the loan.

Emphasis on Good Judgment

Good judgment is the all-important thing in measuring the risk involved in buying a home—the borrower's own best judgment combined with the sound judgment of experienced mortgage lenders and of FHA.

Home Improvement Loans

There are various ways for home owners to finance home improvements with FHA insured loans. Some involve either refinancing a mortgage or using an "open end" device. The plans described here cover separate loans for home improvement.

Loans for major home improvements are insured under Sections 203(k) and 220(h) of the National Housing Act. These two types of loans have similar terms, but the 220(h) loans can be used only in urban renewal areas. Both can run from 3 to 20 years and can amount to as much as $10,000 per family unit ($14,500 in high-cost areas). Both have a 6 percent interest rate, plus ½ percent FHA insurance premium.

FHA charges an application fee on these loans. The loan is secured by a recorded lien against the property. The lender may require the borrower to pay a closing charge of not more than 1 percent or, if the lender makes inspections and partial disbursements while the work is in progress, not more than 2½ percent. The borrower is charged for recording the security, for credit report, title examination, and other items that vary from place to place.

Loans for home improvement are also insured under Title I of the National Housing Act. The loan cannot be over $3,500 and the term not over five years. The lender can charge a discount at the rate of $5 per $100 per year on the first $2,500 and $4 per $100 per year on the amount above $2,500. (This equals an interest rate of 8.54 percent to 9.58 percent.)

The following tables show monthly payments and total cost of interest for some typical loans.

Table I—Monthly Payment to Principal, Interest, and Mortgage Insurance Premium, and Total Monthly Payment at 6 Percent

Term of Loan	$10,000			$15,000			$20,000		
	Principal and Interest	Mortgage Insurance Premium*	Total Monthly Payment	Principal and Interest	Mortgage Insurance Premium*	Total Monthly Payment	Principal and Interest	Mortgage Insurance Premium*	Total Monthly Payment
20 years	$71.70	$4.12	$75.82	$107.55	$6.17	$113.72	$143.40	$8.23	$151.63
25 years	64.50	4.13	68.63	96.75	6.20	102.95	129.00	8.27	137.27
30 years	60.00	4.14	64.14	90.00	6.21	96.21	120.00	8.29	128.29

*Monthly premium during first year of loan at the rate of ½% per annum on average outstanding balance during year.

Table II—Total Cost of Interest at 6 Percent and Total Mortgage Insurance Premiums

Term of Loan	$10,000			$15,000			$20,000		
	Interest	Mortgage Insurance Premium	Total	Interest	Mortgage Insurance Premium	Total	Interest	Mortgage Insurance Premium	Total
20 years	$ 7,181.56	$558.48	$ 7,780.04	$10,772.34	$ 897.72	$11,670.06	$14,363.12	$1,196.96	$15,560.08
25 years	9,301.51	775.14	10,076.65	13,952.27	1,162.71	15,114.98	18,603.02	1,550.28	20,153.30
30 years	11,554.81	962.90	12,517.71	17,332.22	1,444.35	18,776.57	23,109.62	1,925.80	25,035.42

Taxes and hazard insurance are added to the monthly payments, but not shown in these charts.

*Monthly premium during first year of loan at the rate of ½% per annum on average outstanding balance during year.

Sec. 203(k) and Sec. 220(h)

Table III—Monthly Payment to Principal, Interest at 6% per Annum, and FHA Insurance Premium

	5 Year Loan			10 Year Loan			15 Year Loan			20 Year Loan		
Amount of Advance	Principal and Interest	FHA Insurance Premium*	Total Monthly Payment	Principal and Interest	FHA Insurance Premium*	Total Monthly Payment	Principal and Interest	FHA Insurance Premium*	Total Monthly Payment	Principal and Interest	FHA Insurance Premium*	Total Monthly Payment
$1,000	$19.34	$ .38	$ 19.72	$ 11.11	$ .40	$ 11.51	$ 8.44	$ .41	$ 8.85	$ 7.17	$ .41	$ 7.58
2,500	48.35	.96	49.31	27.78	1.01	28.79	21.10	1.02	22.12	17.93	1.03	18.96
6,000	116.04	2.30.	118.34	66.66	2.41	69.07	50.64	2.45	53.09	43.02	2.47	45.49
10,000	193.40	3.83	197.23	111.10	4.02	115.12	84.40	4.09	88.49	71.70	4.12	75.82

*Monthly premium during first year of loan at the rate of ½% per annum on average outstanding balance during the year.

Table IV—Total Cost of Interest and Insurance Premiums

Amount of Advance	5 Year Loan			10 Year Loan			15 Year Loan			20 Year Loan		
	Interest	FHA Insurance Premium	Total Amount	Interest	FHA Insurance Premium	Total Amount	Interest	FHA Insurance Premium	Total Amount	Interest	FHA Insurance Premium	Total Amount
$1,000	$ 160	$ 13	$ 173	$ 332	$ 28	$ 360	$ 519	$ 43	$ 562	$ 718	$ 60	$ 778
2,500	400	33	433	830	69	899	1,297	108	1,405	1,795	150	1,945
6,000	959	80	1,039	1,991	166	2,157	3,113	259	3,372	4,309	359	4,668
10,000	1,599	133	1,732	3,319	277	3,596	5,188	432	5,620	7,182	598	7,780

Table V—Title I Property Improvement Loans with Equal Monthly Payments to Principal and Interest

		12 Month Loan		24 Month Loan		36 Month Loan		48 Month Loan		60 Month Loan	
Amount of Advance	Maximum Discount per Year per $100	Monthly Payment	Equivalent Interest Rate	Monthly Payment	Equivalent Interest Rate	Monthly Payment	Equivalent Interest Rate	Monthly Payment	Equivalent Interest Rate	Monthly Payment	Equivalent Interest Rate
$ 500	$5	$ 43.86	9.58%	$ 22.95	9.43%	$ 15.97	9.30%	$12.49	9.18%	$10.40	9.05%
1,000	5	87.72	9.58	45.89	9.43	31.94	9.30	24.97	9.18	20.79	9.05
2,500	5	219.30	9.58	114.71	9.43	79.85	9.30	62.42	9.18	51.96	9.05
3,500	5 & 4	306.11	9.01	159.72	8.89	110.93	8.77	86.53	8.65	71.89	8.54

Table VI—Total Cost of Interest

Amount of Advance	Maximum Discount per Year per $100	12 Month Loan	24 Month Loan	36 Month Loan	48 Month Loan	60 Month Loan
$ 500	$5	$ 26	$ 51	$ 75	$ 99	$123
1,000	5	53	101	150	198	247
2,500	5	132	253	374	496	617
3,500	5 & 4	173	333	493	653	813

Equal Opportunity in Housing

FHA regulations under the President's Executive Order 11063 of November 20, 1962, require that housing provided with FHA assistance be made available without discrimination because of race, color, creed, or national origin.

The regulations prohibit any person, firm, or group receiving the benefits of FHA mortgage insurance or doing business with FHA from practicing such discrimination in lending or in the sale, rental, or other disposition of the property. Violations may result in discontinuation of FHA assistance.

One- or two-family dwellings which have been occupied by the owner are exempt from the regulations; but if the purchaser of such a home wishes to finance it with an FHA-insured mortgage the lender may not refuse to make the loan because of the buyer's race, color, creed, or national origin.

The FHA in Brief

Since its establishment in 1934, the Federal Housing Administration has written mortgage and loan insurance amounting to well over a hundred billion dollars. This amount covers mortgage insurance on millions of homes, on more than a million living units in multifamily projects, and on many millions of property improvement loans. Altogether, FHA has helped between 35 million and 40 million families to improve their housing conditions.

Congress provided the FHA mortgage and loan insurance system to help improve housing standards, to promote the use of sound financing methods, and to help keep the mortgage market steady. FHA supports itself through income derived from fees, insurance premiums, and investments. Its insurance reserves are well over a billion dollars.

All loans insured under FHA programs are made by private lenders. FHA does not lend money or build houses. The first programs dealt with insured home-improvement loans, home-mortgage loans, and rental-housing mortgage loans. Additional programs cover insurance of: mortgages to develop land, to finance group practice facilities, and to provide homes for servicemen, housing for people of low and moderate income, housing in urban-renewal areas, housing for the elderly or handicapped, nursing homes, cooperative housing, condominiums, experimental housing, military housing; and loans for major home improvements. Also, FHA administers the rent supplement program of the Department of Housing and Urban Development.

FHA has had a marked influence on the location, volume, and kind of housing built in the United States. It has helped to make the low-downpayment, long-term, fully amortized mortgage the standard in mortgage lending.

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